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No. 88-1354

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1988

EATON CORPORATION,
Petitioner,
VS.
THE PKL COMPANIES, INC.,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION

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COUNTER-STATEMENT OF QUESTIONS PRESENTED*

1. Whether this Court's review of the constitutionality of a punitive damage award is warranted where the petitioner failed to raise constitutional challenges to the award in the state courts and where no state court passed on the constitutional issues.

2. Whether a civil punitive damage award that, as California law requires, bears a reasonable relationship to plaintiff's actual damages, to the reprehensibility of the wrongdoer's misconduct and to the wrongdoer's net worth violates either the Eighth Amendment's Excessive Fines Clause or the Fourteenth Amendment's Due Process Clause.

3. Whether a state statute that imposes on a surviving corporation in a merger responsibility for the disappearing corporation's punitive damage liabilities violates the Due Process Clause of the Fourteenth Amendment.

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* Respondent The PKL Companies, Inc. is a corporation in liquidation whose assets have been transferred to the PKL Liquidating Trust. The beneficiaries of the trust are approximately 1300 of respondent's shareholders. The trustees of the trust are Frederic S. Papert, Bernard P. Dolan and Charles P. Spira. Respondent has no other affiliates, parents or subsidiaries.

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EATON CORPORATION,
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VS.

THE PKL COMPANIES, INC.,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION[1]

COUNTERSTATEMENT OF THE CASE

A. Prefatory Statement

In August, 1983 a jury awarded respondent The PKL Companies, Inc. ("PKL") $2,633,599 in actual damages and $15,000,000 in punitive damages for a massive fraud and breach of fiduciary duty perpetrated by petitioner's corporate predecessors, Macrodata Corp. and Cutler-Hammer, Inc.[2] Eaton never challenged the punitive dam-

[1]By letter dated March 2, 1989, the Clerk of the Court granted respondent an extension of time until April 17, 1989, in which to file this Opposition.

[2]The lawsuit originally named Macrodata Corp. ("Macrodata") and Cutler-Hammer, Inc. ("Cutler-Hammer") as defendants. As discussed below, Macrodata subsequently merged into Cutler-Hammer. Then, two years after the action began, petitioner Eaton Corporation ("Eaton") absorbed Cutler-Hammer in a merger and was substituted as the sole defendant in the action pursuant to a state statute governing obligations of surviving corporations in mergers.

age award in the courts below on constitutional grounds. Instead, it contested the award in the lower courts solely on state law grounds.[3]

But even if Eaton's constitutional claims had been properly raised below, they would not merit review, because the punitive damage award in this case is, as California law required it to be, reasonable and proportionate in all respects. More specifically, as both the trial court and court of appeal expressly found, the award bears a reasonable relationship to actual damages, to the reprehensibility of the wrongdoer's misconduct and to the wrongdoer's net worth.[4] The award thus meets all of the criteria that Eaton now contends it must satisfy under the Constitution.

B. The Facts Proved At Trial

At the beginning of 1974 PKL owned 160,011 shares of unregistered stock in Macrodata, a publicly traded corporation that manufactured semiconductor test equipment. (App. A-2). PKL had a contractual right to require Macrodata to register the shares with the Securities Exchange Commission ("SEC"). *(Id.)*.

In 1974, Cutler-Hammer, an industrial and electrical conglomerate, decided to buy 100 percent of Macrodata's

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California Corporations Code § 1107(a) & (c) (West 1977). (*See* Petition For Writ of Certiorari ("Pet.") 4).

[3]This was the second punitive damage verdict against Eaton in this case. In a previous trial, a jury awarded PKL $2,250,000 in compensatory damages and $17,500,000 in punitive damages. (Pet. 5 n. 5 and Appendix A at A-1 n. 1). A new trial was granted on the grounds, among others, that portions of PKL's damage proof in the first trial should have been excluded and that, solely because of that erroneously admitted evidence, damages were excessive (1 Clerk's Transcript ("C.T.") 338).

[4]*See* 54 Reporters Transcript ("R.T.") 9809 and Opinion of California Court of Appeal, Appendix A to Petition for Writ of Certiorari, pp. A-53 to A-55. Further citations to the Opinion of the California Court of Appeal are designated as "App. A," followed by the appropriate page numbers.

outstanding stock at less than fair value. *(Id.)*. Throughout 1974 and 1975, therefore, Cutler-Hammer bought Macrodata stock only in private unreported transactions, thereby artificially holding down the market price of the stock. (App. A-2, A-3).

Meanwhile, as part of its scheme to buy Macrodata at below fair value, Cutler-Hammer also tried to negotiate a private purchase of PKL's Macrodata stock at an unfairly low price. PKL, however, refused to sell and instead exercised its contractual right to demand registration of its shares so it could distribute them to its 1300 shareholders. (App. A-3).

In June 1975, Cutler-Hammer became Macrodata's majority shareholder. (App. A-3). Over the next six months, Macrodata, aided and abetted by Cutler-Hammer, several times falsely promised that it would register PKL's Macrodata stock. (App. A-4, A-32 to A-35). These false promises caused PKL to await the promised registration, to delay suing to compel registration, and to refrain in the interim from seeking other purchasers of its Macrodata stock. *(Id.)*.

In September 1975, Cutler-Hammer — which, as Macrodata's majority shareholder, was required to include Macrodata's 1975 financial results in its own 1975 financial statement — publicly predicted through its chairman, Edmund Fitzgerald, that Cutler-Hammer would earn $4 per share in 1975. (App. A-5). Two months later, Cutler-Hammer sent its manager of internal audit, George Thomas, to Macrodata. *(Id.)*. One aspect of Thomas' assignment was to "make Macrodata look good" so Cutler-Hammer could meet Fitzgerald's earnings prediction. *(Id.)*.

Before Cutler-Hammer closed its books for 1975, employees of Macrodata advised Thomas that Macrodata's 1975 loss would be $2.4 million or higher, which posed a grave threat to Fitzgerald's earnings prediction. (App. A-6). In response, Thomas told Macrodata's financial officers "my boss at Cutler-Hammer says hold the loss at

$2.2 million"; he then instructed them not to correct certain inventory errors which would have increased the amount of the loss. *(Id.)*. The Macrodata officials complied with Thomas' instructions and, as a result of Cutler-Hammer's pressure to "hold the loss," also failed to correct other significant errors. (App. A-6, A-42 to A-43).

In mid-January 1976, as a result of the falsification of its books, Macrodata reported to Cutler-Hammer a 1975 loss of $2.28 million. (App. A-6). This $2.28 million figure, which Cutler-Hammer included in its 1975 financial statement, permitted Cutler-Hammer to report earnings of $4.02 per share, and thus to fulfill Fitzgerald's prediction. (*Id.*).

By February 1976 the extent of Macrodata's false accounting entries had become well known to Cutler-Hammer's senior management. (*Id.*). But rather than correcting these inaccuracies, Cutler-Hammer devised a plan to escape blame for the accounting fraud and, at the same time, to fulfill its goal of capturing all of Macrodata's stock at an unfair price. (App. A-6 to A-8). Specifically, Cutler-Hammer continued to conceal the inaccuracies in Macrodata's 1975 financial statement and then intentionally permitted the false financial statement to become public in April 1976. (*Id.*). After the statement became public, Cutler-Hammer revealed the accounting fraud to the SEC and to Macrodata's auditors and blamed Macrodata's management for the misstatements. (*Id.*). As Cutler-Hammer expected, the SEC then suspended trading in Macrodata stock, and the auditors withdrew their certification of Macrodata's 1975 financial statement and performed a reaudit. (*Id.*).

The reaudit revealed what Cutler-Hammer had known all along: Macrodata's true loss for 1975 was $4.53 million, nearly double the $2.28 million loss previously reported. (App. A-8). The revelation of the false accounting, the SEC suspension, the reaudit, and the resulting loss of investor confidence in the integrity of

Macrodata's management permanently destroyed the market in Macrodata stock. (*Id.*).

Meanwhile, Macrodata did nothing to fulfill its numerous promises to register PKL's Macrodata shares. Accordingly, in January 1976 PKL filed a federal diversity action to compel the registration that Macrodata had first promised six months earlier. (App. A-8). The following month Macrodata — again aided and abetted by Cutler-Hammer — proposed that it seek an SEC "no action" letter as an alternative to registration. (App. A-8, A-9).

In early April 1976, the SEC wrote Macrodata that the request for no action had been granted in part and denied in part. (App. A-9). The SEC's partial denial and the late timing of its letter — just eight days before Cutler-Hammer destroyed the market for Macrodata stock — made the no action letter useless to PKL and its shareholders. (*Id.*). Accordingly, PKL dismissed its action to compel registration, and in December 1976 filed this action, charging, *inter alia*, that Cutler-Hammer had, through misrepresentation, concealment and self-dealing, sought to obtain PKL's Macrodata shares at an unfair price, and that Cutler-Hammer was thereby liable in damages (including $25 million in punitive damages) for fraud and breach of fiduciary duty. (29 R.T. 5053; 1 C.T. 1).[5]

Undaunted by PKL's pending lawsuit, in September 1977 Cutler-Hammer used its control of Macrodata to effect a merger with Macrodata in which Macrodata's shareholders, including PKL, were forced to exchange their Macrodata shares for shares in Cutler-Hammer at a grossly inadequate rate of exchange. (App. A-9, A-10; Ex. 1022; 12 R.T. 2000-01). Relying, in part, on the lack of a

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[5]As indicated above, Eaton became the sole defendant in place of Macrodata and Cutler-Hammer after the action commenced (*see* note 2, *supra*). Eaton thus entered the litigation with full knowledge of the Complaint's $25 million punitive damage claim (App. A-53 n. 19; 1 C.T. 13, 19). Indeed, Cutler-Hammer specifically informed its shareholders, including Eaton, of the magnitude of that claim in its 1978 Annual Report (Exh. 1347, p. 35).

public market in Macrodata stock — a market that Cutler-Hammer had itself intentionally destroyed — Cutler-Hammer set the exchange ratio for the stock-for-stock merger at only .165 Cutler-Hammer shares for each Macrodata share. (App. A-9, A-10; Ex. 1022, 1122; 44 R.T. 7908). In fact, Macrodata's shares were worth at least four times more, or .66 Cutler-Hammer shares for each Macrodata share. (*Id.*).

Had Cutler-Hammer applied the correct .66 exchange ratio, Cutler-Hammer would have paid PKL $2,633,599 more than it paid for PKL's shares. (App. A-10). As the Court of Appeal succinctly observed, by "destroying the market for PKL's Macrodata shares [Cutler-Hammer] was thus able to acquire PKL's shares in the merger at a price below their fair value." (App. A-25).

Finding that this conduct constituted fraud and breach of fiduciary duty, the jury awarded PKL the $2,633,599 shortfall in the merger price as compensatory damages and $15,000,000 as punitive damages. (App. A-2, A-10). In so doing, the jury followed the trial court's instructions that an award of punitive damages in California must bear a reasonable relationship to plaintiff's actual damages and must take into consideration the wrongdoer's wealth and the reprehensibility of the wrongdoer's misconduct. (Jury Instructions 41 & 42, App. F-1 to F-3).

C. Post-Trial And Appellate Proceedings

Following the jury's verdict, Eaton moved for a new trial. After re-weighing the evidence (as required by California law) and finding "the amount of compensatory and punitive damages . . . reasonable," the trial judge denied the motion. (54 R.T. 9809; Appendix 1 hereto). Eaton appealed, and the Court of Appeal affirmed.

Significantly, Eaton raised no constitutional claims either in the trial court or in the court of appeal. Its challenges to the punitive damage award in both courts rested solely on state law grounds.

After the court of appeal's decision, Eaton filed a petition for rehearing, which also failed to challenge the punitive damage award on constitutional grounds. Upon the court of appeal's denial of this petition, Eaton filed a petition for review in the California Supreme Court. This petition likewise failed to raise constitutional challenges to the punitive damage award. Although the petition for review (primarily in a footnote) casually referred to the discussion of constitutional issues contained in *Bankers Life & Casualty Co. v. Crenshaw,* 108 S.Ct. 1645 (1988), the petition did *not* ask the California Supreme Court to review the constitutionality of the jury's punitive damage award. The state supreme court denied the petition for review without opinion.

REASONS FOR DENYING THE WRIT

The petition should be denied for several reasons. First, since Eaton failed to raise its constitutional arguments below, this Court has no jurisdiction to consider them. Second, even if, as a matter of federal law, Eaton had properly raised its constitutional challenges to the punitive damage award in the lower courts, its failure to raise those arguments in accordance with *state* rules of procedure would provide an adequate and independent state ground of decision barring this Court's review of the constitutional issues.

Third, the punitive damage award in this case, as required by California law, bore a reasonable relationship to plaintiff's actual damages, to the reprehensibility of the wrongdoer's misconduct, and to the wrongdoer's net worth. The award also was predictable in amount and was properly assessed against Eaton, as Cutler-Hammer's successor by merger, pursuant to a valid state statute. Accordingly, even if this Court were to hold the Eighth and Fourteenth Amendments applicable to civil punitive damage awards, the award would meet any criteria of fairness, reasonableness and proportionality that the Constitution might require.

I.

BECAUSE EATON DID NOT PROPERLY RAISE ITS CONSTITUTIONAL CLAIMS BELOW, ITS PETITION SHOULD BE DENIED

Since the California Supreme Court issued no opinion in this case, Eaton's petition to this Court seeks, as it must, a writ of certiorari to the California Court of Appeal, the only court that rendered an opinion below. *See Board of Directors of Rotary International v. Rotary Club of Duarte,* 481 U.S. 537, 549-50 (1987) (petition for writ of certiorari to California Court of Appeal).[6] This Court, however, lacks jurisdiction to review the constitutionality of the punitive damage award approved by the court of appeal because Eaton did not challenge that award on constitutional grounds either in the trial court or in the court of appeal.

A. By Failing To Raise Its Constitutional Claims In The State Courts, Eaton Waived Its Right To Invoke This Court's Jurisdiction

It is well settled, as a matter of federal law, that this Court may re-examine the judgment of a state court "only if the record as a whole shows either expressly or by clear implication that the federal claim was adequately presented in the state system." *Webb v. Webb,* 451 U.S. 493, 496, 498 n. 4 (1981). Here, the record as a whole unequivocally shows the opposite: Eaton never raised its constitutional arguments either in the trial court or in the court of appeal. Therefore, as this Court recently held on virtually identical facts, the Court has no jurisdiction to issue a writ of certiorari to the California Court of

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[6]Under California law, the state supreme court's denial of Eaton's petition for review did not constitute a ruling on the merits of any of the arguments raised in the petition. Cal. Rules of Court 28, Advisory Committee Comment — 1985, p. 28 (West 1988); *People v. Triggs,* 8 Cal.3d 884, 890-91, 106 Cal.Rptr. 408 (1973), disapproved on other grounds, *People v. Lilienthal,* 22 Cal.3d 891, 896 n. 4, 150 Cal.Rptr. 910 (1978).

Appeal. *Rotary Club of Duarte, supra,* 481 U.S. at 549-50. *See also Chicago, Indianapolis & Louisville Railway Co. v. McGuire,* 196 U.S. 128, 130-33 (1905).[7]

Ignoring its failure to raise constitutional claims in both the trial court and the court of appeal, Eaton contends that it preserved those claims for review in this Court by purportedly asserting them in its petition for review to the California Supreme Court. (Pet. 9-15). This argument lacks merit for two reasons.

First, as this Court has specifically held, an attempt to raise federal constitutional issues for the first time in the California Supreme Court comes too late to preserve this Court's jurisdiction over those issues. *Rotary Club of Duarte, supra,* 481 U.S. at 549-50. *See also Street v. New York,* 394 U.S. 576, 581-582 (1969) (raising constitutional issue for first time in state appellate court does not preserve issue for review in this Court). Accordingly, even if Eaton had unambiguously raised constitutional challenges to the punitive damage award in the California

[7]Even if Eaton's failure to raise its constitutional claims were merely a prudential, rather than a jurisdictional, restriction on this Court's power to act (*see Bankers Life, supra,* 108 S.Ct. at 1651), this would be an inappropriate case in which to exercise that prudential power. The petition attempts to place at issue the constitutionality of California's entire punitive damage scheme. It would hardly be prudent for this Court to examine that far-reaching constitutional question without first giving the state court the opportunity to address the issue on state constitutional grounds (*e.g.,* Cal. Const. Article I, Section 7 (Due Process) and Section 17 (Excessive Fines)) and without receiving the benefit of at least some discussion of the federal issue in the state court opinion under examination. *See Bankers Life, supra,* 108 S.Ct. at 1651. Indeed, just this term the Court declined to consider constitutional challenges to Alabama's punitive damage laws where the appellate court opinion — like the court of appeal's opinion here — did not address the merits of petitioner's federal constitutional claims, and where petitioner failed, as Eaton did here, to raise those constitutional claims in the trial court. *Nationwide Mutual Ins. Co. v. Clay, cert. denied,* 109 S.Ct. 863 (January 23, 1989).

Supreme Court, these belated challenges would not provide a basis for jurisdiction in this Court.

Second, Eaton's petition for review to the California Supreme Court in fact did *not* challenge the punitive damage award on constitutional grounds. Under California law, all issues presented in a petition for state supreme court review must be set forth "at the beginning of the body of the petition." Cal. Rules of Court 28(e)(2) (Appendix 2 hereto). None of the issues presented at the beginning of Eaton's petition to the California Supreme Court, however, even mentioned the United States Constitution, much less the specific provisions of the Eighth and Fourteenth Amendments on which Eaton relies in this Court.[8]

The cursory reference to *Bankers Life* buried on pages 12-13 of Eaton's twenty-five page petition for review does not, as Eaton argues (Pet. 9-13), overcome this glaring omission. This Court has jurisdiction to review constitutional issues arising from state court proceedings only if "there [is] no doubt from the record that a claim under a federal statute or the Federal Constitution was presented in the state courts and that those courts were apprised of the nature or substance of the federal claim at the time and in the manner required by the state law." *Bankers Life*, 108 S.Ct. at 1650, *quoting Webb v. Webb, supra*, 451 U.S. at 501. The purpose and import of the reference to *Bankers Life* in Eaton's petition for review, however, are full of doubt. The petition's text, in a single sentence, states only that a purported absence of standards governing punitive damages in California "*may* well render such damages unconstitutional on due process grounds." (App. G-18) (emphasis added). And the petition's footnote discussion of *Bankers Life* merely summarizes the result of that case without explaining why the summary is

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[8]The entire text of the issues presented to the California Supreme Court in Eaton's petition for review is set forth in Appendix 3 hereto and in Appendix G to the Petition for Writ of Certiorari at pages G-3 to G-5.

there. But nowhere did either the text or the footnote ask the state Supreme Court to *review* the constitutionality of the punitive damages award. This Court has repeatedly held that such casual references to federal rights — which at most merely suggest that such rights "may" have been violated — are insufficient to satisfy this Court's standards for review. *Bankers Life, supra*, 108 U.S. at 1650; *Rotary Club of Duarte, supra*, 481 U.S. at 550 n. 9; *Beck v. Washington*, 369 U.S. 541, 552-53 (1962); *McGuire, supra*, 196 U.S. at 131-32.

Eaton offers several excuses for failing to preserve its constitutional arguments in the trial court and court of appeal, all of which lack merit. Eaton first contends that under California law a litigant "may" raise for the first time in the California Supreme Court new theories that implicate important questions of public policy and involve pure questions of law. (Pet. 11). While the California Supreme Court has, in exceptional cases, permitted a party to advance legal arguments not made below, its normal rule is to decline to consider constitutional issues that were neither raised at trial nor briefed to the court of appeal.[9] Moreover, where, as here, the highest state court has failed to pass upon a federal question, this Court will "assume[ ] that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary." *Street, supra*, 394 U.S. at 582. Eaton has made no such showing, and thus it may not invoke this Court's jurisdiction based on the exception to California's normal rule. *Rotary Club of Duarte, supra*, 481 U.S. at 550.[10]

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[9]*People v. Mabry*, 71 Cal.2d 430, 441, 78 Cal.Rptr. 655 (1969); *People v. Tolbert*, 70 Cal.2d 790, 804, 76 Cal.Rptr. 445 (1969); *Selleck v. Globe Int'l, Inc.*, 166 Cal.App.3d 1123, 1133 n. 5, 212 Cal.Rptr. 838 (1985); Cal. Rules of Court 29(b)(1) (West 1988) (Appendix 2 hereto).

[10]In *Atlantic Richfield Co. v. Nielsen, cert. denied*, 108 S.Ct. 2023 (1988), the Court last term refused to review constitutional challenges to California's punitive damage law that were raised for the

Eaton next argues that it would have been pointless to raise its constitutional arguments in the trial court and court of appeal because such arguments are contrary to established California Supreme Court precedents. (Pet. 11- 13). No California Supreme Court decision, however, has ever ruled on the precise issues raised here: (i) whether the Eighth Amendment's Excessive Fines Clause applies to civil punitive damage awards; (ii) whether the grant to California juries of strictly limited discretion to award punitive damages violates the Fourteenth Amendment's Due Process Clause; and (iii) whether the Due Process Clause precludes imposition of liability upon the surviving corporation in a merger for the punitive damage obligations of the disappearing corporation.[11] In any event, this Court, not the California Supreme Court, is the final arbiter of these federal questions. Eaton was thus not entitled to bypass the state courts simply because it may have believed that they would be unsympathetic to its constitutional arguments. *Engle v. Isaac,* 456 U.S. 107, 130 (1982) ("the futility of presenting an objection to the

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first time in a petition for review to the California Supreme Court. Eaton's discussion of *Nielsen* (Pet. 13 n. 10) suggests no reason why this case should be treated differently.

[11]The California Supreme Court cases cited by Eaton (Pet. 7, 13) simply do not address these issues. *Petersen v. Superior Court*, 31 Cal.3d 147, 151, 181 Cal.Rptr. 784 (1982), involved only the ex post facto clause (Art. I, § 9, cl. 3) of the Federal Constitution. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 819-20, 157 Cal.Rptr. 482 (1979), made no constitutional rulings whatever. *Bertero v. National General Corp.*, 13 Cal.3d 43, 66 n. 13, 118 Cal.Rptr. 184 (1974), merely held that the language of Cal. Civil Code § 3294 (West 1970) was not unconstitutionally vague.

Eaton itself recognized below that these cases did not deal with the precise issues raised here. In its petition for review Eaton stated only that the California Supreme Court "had *seemed* to uphold such damages" against Eighth and Fourteenth Amendment challenges (App. G-18 n. 6, citing *Petersen v. Superior Court, supra*) (emphasis added). As noted above, however, *Petersen* never discussed, much less ruled upon, the Excessive Fines and Due Process Clause arguments that Eaton asserts in this Court.

state courts cannot alone constitute cause for a failure to object at trial").

Eaton also appears to suggest that it had no opportunity to bring to the court of appeal's attention this Court's decisions in *Aetna Life Ins. Co. v. Lavoie,* 475 U.S. 813 (1986) and *Bankers Life.* (Pet. 13). But the record shows that Eaton had abundant opportunity to alert the court of appeal to these decisions. *Lavoie* was decided April 22, 1986. Eaton thus had ample time to refer to *Lavoie* in the opening brief it filed in the court of appeal on May 9, 1986 and in the reply brief it filed in that court on February 9, 1987.[12] *Bankers Life*, moreover, was decided May 16, 1988, two and one-half weeks before the June 1, 1988 oral argument in the court of appeal. This two and one-half week interval provided Eaton the opportunity to submit, in accordance with normal California practice, a supplemental letter brief bringing *Bankers Life* to the court of appeal's attention.[13] Eaton did, in fact, submit a letter brief to the court of appeal the day before oral argument (Appendix 4 hereto); but the letter made no reference whatever to *Bankers Life.*

Finally, Eaton argues that it need not have asserted its alleged constitutional rights in the state courts *at all* because at that time these rights had "not yet [been] declared to exist." (Pet. 13, *citing Curtis Publishing Co. v. Butts,* 388 U.S. 130 (1967)). *Curtis* does not support Eaton's proposed broad exception to this Court's normal jurisdictional rules.

The Court assumed jurisdiction in *Curtis* despite defendant's failure to assert its constitutional arguments

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[12]It should be noted that the petitioner in *Metromedia, Inc. v. April Enterprises*, No. 88-625, *pet. for cert. filed* Oct. 14, 1988, had no trouble arguing the significance of *Lavoie* in the California courts as early as August 1986. (*See* Petition for Writ of Certiorari in No. 88-625 at 4.)

[13]*See, e.g., Meier v. Ross General Hospital,* 69 Cal.2d 420, 423-24 n. 1, 71 Cal.Rptr. 903 (1968).

before trial because of a unique combination of facts: (i) the First Amendment issue involved in *Curtis* "was prompt[ly]" raised in a motion for new trial; (ii) the issue was raised soon enough to permit it to be aired in both the trial and appellate courts and thus to prevent prejudice to plaintiff and (iii) the First Amendment right involved was "the 'matrix, the indispensable condition, of nearly every other form of freedom.' " 388 U.S. at 145 (citations omitted). However, here, in contrast to *Curtis*, Eaton failed to present its constitutional arguments promptly; the courts below never ruled on the constitutional issues; and, the issues do not implicate the significant First Amendment interests involved in *Curtis*. *Curtis* thus plainly does not apply here.[14]

B. Eaton's Failure To Raise Its Federal Claims At The Time And In The Manner Required By State Procedural Rules Constitutes An Adequate, Independent State Ground Of Decision Barring This Court's Review Of Those Claims

Even if Eaton's petition to the state supreme court were sufficient, as a matter of *federal* law, to preserve this Court's jurisdiction over Eaton's constitutional arguments, Eaton's violations of *state* rules of procedure would bar the Court's consideration of the federal claims. *See Webb v. Webb, supra,* 451 U.S. at 498 n. 4. As this Court has frequently stated, failures to present federal questions in conformance with state procedural rules constitute adequate and independent state grounds of decision barring the Court's consideration of the federal

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[14]Were the Court to ignore the special facts of *Curtis*, and to adopt instead the broad "rights not yet declared to exist" exception that Eaton urges, the exception would swallow the rule that constitutional issues must be raised and preserved at the first opportunity in the lower courts. Every case attacking the constitutionality of a state statute or urging the extension of a constitutional doctrine would perforce come within the exception and expand the filings of petitions for writs of certiorari beyond manageable limits.

issues. *Michigan v. Tyler,* 436 U.S. 499, 512 n. 7 (1978); *Henry v. Mississippi,* 379 U.S. 443, 446 (1965).

Here, as noted above, Eaton failed to comply with California's procedural rules requiring (i) that "[a] claimed violation of a constitutional right . . . must be raised in the trial court to preserve the issue for appeal"[15] and (ii) that all issues presented for review to the California Supreme Court must be set forth at the beginning of the body of the petition.[16] These derelictions provide adequate and independent state grounds barring review of Eaton's constitutional claims in this Court.

II.

EVEN IF THE CONSTITUTIONAL ISSUES THAT EATON RAISES WERE PROPERLY BEFORE THE COURT, THIS WOULD BE AN INAPPROPRIATE CASE FOR REVIEW OF THOSE ISSUES

A. Because The Jury's Punitive Damage Award Is Reasonable And Proportionate In All Respects, Review Of Eaton's Excessive Fines Clause Argument Is Not Warranted In This Case

The first question presented in Eaton's petition — whether the Eighth Amendment's Excessive Fines Clause limits the amount of punitive damages awardable under state law — is now before the Court in *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc., cert. granted,* 109 S.Ct. 527 (1988). PKL submits that, for the

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[15]*Selleck v. Globe Int'l Inc., supra,* 166 Cal.App.3d at 1133 n. 5. *See also* Cal. Rules of Court 29(b)(1) ("As a matter of policy, on petition for review the Supreme Court normally will not consider: (1) any issue that could have been but was not timely raised in the briefs filed in the Court of Appeal").

[16]Cal. Rules of Court 28(e)(2) ("At the beginning of the body of the petition, the petition shall state the issues presented for review . . . *Only the issues set forth in the petition and answer or fairly included in them need be considered by the Court.")* (emphasis added). *See Beck v. Washington, supra,* 369 U.S. at 553.

reasons set forth in Respondents' Brief in *Browning-Ferris*, the Eighth Amendment's proscription against excessive fines does not apply to civil punitive damage awards. However, even were this Court to conclude otherwise, significant distinctions between this action and *Browning-Ferris* make the issue unworthy of further review in this case.

This Court has repeatedly stressed that outside the capital punishment context successful Eighth Amendment challenges to particular punishments "will be exceedingly rare." *Solem v. Helm*, 463 U.S. 277, 289-90 (1983), *quoting Rummel v. Estelle*, 445 U.S. 263, 272 (1980). *Solem* also indicates that the standard for judging both criminal fines and imprisonment under the Eighth Amendment should be "proportionality" (463 U.S. at 284-86, 288-89) — the same standard Eaton contends should apply to civil punitive damage awards (Pet. 16-18). This standard, in turn, requires examination of "the gravity of the offense and the harshness [or reasonableness] of the penalty." *Id.* at 290-91.

Whether the criteria of proportionality and reasonableness have been met is an issue hotly contested in *Browning-Ferris*. No similar dispute exists here. Unlike the punitive damage award in *Browning-Ferris*, the award in this case is proportionate and reasonable in every respect.

In *Browning-Ferris*, the ratio between the $6 million punitive damage award and plaintiff's $51,146 in actual damages was *117 to 1*. Here, in contrast, the ratio between punitive damages and PKL's actual damages of $2,633,599 is only 5.7 to 1.[17]

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[17]This 5.7 to 1 ratio is also dwarfed by the 27 to 1 ratio in *Nationwide Mutual Ins. Co. v. Clay, cert. denied*, 109 S.Ct. 863 (1989), where punitive damages were $1,250,000 and actual damages were only $46,165. The Court denied certiorari in *Nationwide* this term, and Eaton advances no reason why this case — with its much smaller ratio of punitive to compensatory damages — is more worthy of review than *Nationwide*.

The gravity of the conduct to be punished and deterred in the two cases is also very different. In *Browning-Ferris*, petitioner and respondent were competitors locked in a commercial dispute that resulted in relatively little actual damage to plaintiff ($51,146) and absolutely no gain to defendant. Culter-Hammer, in contrast, was not merely an economic competitor that dealt with PKL at arm's length. Rather, it was a fiduciary that through fraud and deception destroyed the market for PKL's minority shares so it could acquire them for a fraction of their true value. This utterly reprehensible abuse of trust — by which Cutler-Hammer reaped over $2.6 million in illicit profits at PKL's expense — fully warranted the punitive damages awarded to PKL.

The punitive damage award in this case is also proportionate in another respect: it represents less than 10% of Cutler-Hammer's net worth. This percentage — 9.43% of Cutler-Hammer's 1977 net worth of $159,084,405 (Exh. 1131, p. 25) and 6.75% of Cutler-Hammer's 1978 net worth of $222,059,000 (Exh. 1347, pp. 6, 15) — not only is reasonably proportional to Cutler-Hammer's wealth, but also is well within the range of awards approved in other California cases.[18] In light of the severity of Cutler-Hammer's misconduct, an award bearing this ratio to the wrongdoer's net worth simply cannot be deemed to constitute that "exceedingly rare" punishment which is too harsh to pass constitutional muster.

Eaton makes two arguments to support its contrary contention. First, Eaton complains (Pet. 6, 17) that the punitive damage award is too large in comparison to

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[18] *See Devlin v. Kearney Mesa AMC/Jeep/Renault, Inc.*, 155 Cal.App.3d 381, 392, 202 Cal.Rptr. 204 (1984) (17.5%); *Schomer v. Smidt*, 113 Cal.App.3d 828, 170 Cal.Rptr. 662 (1980) (10%); *Goshgarian v. George*, 161 Cal.App.3d 1214, 1228, 208 Cal.Rptr. 321 (1984) (10%); *Zhadan v. Downtown L.S. Motor Distributors*, 100 Cal.App.3d 821, 835, 161 Cal.Rptr. 225 (1979) (6.85%); *Burnett v. National Enquirer, Inc.*, 144 Cal.App.3d 991, 1012, 193 Cal.Rptr. 206 (1983) (5.8%).

Cutler-Hammer's net income (62% of 1977 net income (Exh. 1331, p. 24); 45% of 1978 net income. (Exh. 1347, pp. 6, 15)). But under California law net worth — not net income — is considered the best measure of defendant's wealth for purposes of assessing punitive damages. *Downey Savings & Loan Assn. v. The Ohio Casualty Ins. Co.*, 189 Cal.App.3d 1072, 1100, 234 Cal.Rptr. 835 (1987), *cert. denied* 108 S.Ct. 2023 (1988); *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., supra,* 155 Cal.App.3d at 391. This is properly so. Otherwise, a wealthy defendant guilty of egregious misconduct could simply avoid the realization of net income in the year immediately preceding trial (through, *e.g.,* accounting practices, deferral of revenues, acceleration of expenses, or lack of productivity) and in that way avoid the imposition of large punitive damages for its misbehavior. Indeed, as the evidence in this case revealed, merely through a change in accounting methods Eaton altered the stated amount of net sales in its 1981 annual report by *$12.3 million.* (30 R.T. 5265).

Eaton next argues that the $15,000,000 punitive damage award must be considered excessive because of its "sheer size." (Pet. 16). But Eaton advances no rational reason for concluding that mere size alone renders a punitive damage award constitutionally infirm. To the contrary, where, as here, a fiduciary's reprehensible behavior causes its beneficiary to suffer massive actual damages, a proportionally large damage award undeniably is necessary to serve the punitive and deterrent purposes of exemplary damages.[19] Accordingly, the

[19]It should also be noted that the award in this case is well below the amount of fines levied for securities frauds in other contexts. *See e.g., Despite Reforms, Abuses Still Suspected On Wall Street,* Los Angeles Times, Dec. 24, 1988, § 1, at 1, 19 ($25.3 million fine for insider trading); *Drexel Concedes Guilt On Trading; To Pay $650 Million,* N.Y. Times, Dec. 22, 1988, at A1 ($300 million fine for federal securities violations); *Spreading Scandal: Fall of Ivan F. Boesky Leads to Broader Probe Of Insider Information,* Wall St. J., Nov. 17, 1986 at A1 ($50 million civil penalty plus prison term for illegal insider trading). *See also Sundstrand To Pay U.S. $71 Million,*

Eighth Amendment issues raised by Eaton would not be worthy of review in this case even if Eaton had properly raised those issues below.[20]

B. Because The Jury's Discretion To Award Punitive Damages Was Neither Standardless Nor Unrestrained, And The Amount Of Such Damages Was Predictable, This Is Not A Suitable Case For Review Of Eaton's Due Process Clause Argument

Eaton asserts that this Court should review whether granting a jury "wholly standardless" and "unfettered" discretion to award punitive damages in "completely unpredictable" amounts violates the Fourteenth Amendment's Due Process Clause. (Pet. 19-23). As we demonstrate below, however, review of this issue is not warranted by the facts of this case.

1. California Law Requires Jury Awards Of Punitive Damages To Satisfy Several Well Articulated Standards

In *Bankers Life,* Justice O'Connor expressed concern that in some jurisdictions the discretion granted to juries to award punitive damages is "wholly standardless" because in those jurisdictions "[p]unitive damages are not measured against actual injury, so there is no objective standard that limits their amount." *Bankers Life, supra,*

Chicago Tribune, Jan. 27, 1989, § C, at 1 ($71 million in civil penalties and $127.3 million in fines for defense-contracting fraud); *Fines for Tesoro,* N.Y. Times, Jan. 24, 1979, at D4 ($56 million fine for violating Department of Energy Regulations).

[20]Eaton makes much of the large punitive damage awards discussed in the Rand Institute's 1987 study on punitive damages (Pet. 14-15 n. 11). But Eaton overlooks that even the largest awards in that study (*i.e.*, the top 25%) bore ratios to compensatory damages ranging only from 3:1 at the low end to 5.7:1 at the high end. Peterson, "Punitive Damages — Empirical Findings" (Rand Corp. 1987) at 58. The median ratio for all awards in the study was less than 1.6 to 1. *Id.* These modest ratios are hardly indicative of rampant vigilantism in California juries.

108 S.Ct. at 1655 (concurring opinion). *See also Smith v. Wade*, 461 U.S. 30, 88-89 (1983) (Rehnquist, J., dissenting); *International Brotherhood of Electrical Workers v. Foust*, 442 U.S. 42, 50 n. 14 (1979), *quoting Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974); *Rosenbloom v. Metromedia, Inc.*, 403 U.S. 29, 74-77 (1971) (Harlan, J. dissenting). However, this is not so in California. California juries are instructed, like the jury in this case, that "punitive damages *must* bear a reasonable relationship to actual damages." 2 *California Jury Instructions, Civil* 205 BAJI 14.71 (West 1986) (emphasis added); App. F-2 to F-3. *See Neal v. Farmers Insurance Exchange*, 21 Cal.3d 910, 928, 148 Cal.Rptr. 389 (1978).

California law, moreover, imposes several other standards on the exercise of a jury's discretion to award punitive damages. Thus, California courts routinely instruct juries, as the trial court did here, to limit punitive damage awards to amounts that bear a reasonable relationship to the reprehensibility of the wrongdoer's misconduct and to the wrongdoer's wealth. *Id.* They further instruct that the jury must exercise its discretion to award such damages "without passion or prejudice." *Id.* As the California Supreme Court has explained, these multiple criteria *require* that a punitive damage award not exceed the amount necessary to serve the purposes of punitive damages, *i.e.*, punishment and deterrence. *Neal v. Farmers Insurance Exchange, supra*, 21 Cal.3d at 928.

In sum, the complete lack of standards about which Justice O'Connor expressed concern in *Bankers Life* simply does not exist in California. For this reason alone it would be inappropriate to review Eaton's due process argument in this case.[21]

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[21]Eaton appears to complain that the standards governing awards of punitive damages in California have been established *judicially* rather than by statute (Pet. 20). But as this Court has stated, there is "no difference, from the standpoint of vagueness, whether the standard . . . is one contained in *haec verba* within the statute, or whether it is the judicial measure of constitutional application."

2. Because California Trial And Appellate Courts Carefully Scrutinize Punitive Damage Awards To Ensure Reasonableness And Proportionality, The Discretion of California Juries To Make Such Awards Is Not Unrestrained

In *Bankers Life*, Justice O'Connor observed that, under Mississippi law, a jury's discretion to award punitive damages is totally unrestrained (*i.e.*, unfettered) because " 'the determination of the amount of punitive damages is a matter committed solely to the authority and discretion of the jury.' " 108 S.Ct. at 1656, *quoting* 483 So.2d 254, 278 (Miss. 1985) (opinion below). By contrast, the discretion vested in California juries is not at all unrestrained.

In California, a defendant may, as a matter of right, seek judicial scrutiny of a jury's punitive damage award both in a motion for new trial and on appeal. At each level of review, the trial and appellate courts carefully examine the award to ensure that it neither exceeds the standards imposed on the jury's discretion nor results from passion or prejudice.

The right to move for a new trial provides California litigants important safeguards. In ruling on a motion for new trial, the trial judge "sits not in an appellate capacity but as an independent trier of fact." *Neal v. Farmers Insurance Exchange, supra*, 21 Cal.3d at 933. The judge *must* "grant a new trial on the ground of excessive damages . . . or provide for a reduction of the verdict, if under the evidence he believes it to be too large." *Collins v. Lucky Markets, Inc.*, 274 Cal.App.2d 645, 652, 79 Cal.Rptr. 454 (1969).

California appellate courts police disproportionate punitive damage awards with equal vigilance. They recognize that "it is our duty to intervene in instances where punitive awards are so palpably excessive or grossly disproportionate as to raise a presumption they resulted

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Dennis v. United States, 341 U.S. 494, 515 (1951). *See also Ward v. Illinois*, 431 U.S. 767, 771-773 (1977).

from passion or prejudice." *Burnett v. National Enquirer, Inc.*, 144 Cal.App.3d 991, 1011, 193 Cal.Rptr. 206 (1983).[22]

In short, the completely unrestrained discretion to award punitive damages that juries may have in some jurisdictions simply does not exist in California. California trial and appellate courts vigorously supervise and review such awards; indeed, Eaton itself received the benefit of such judicial scrutiny in this case. For this separate reason, review of Eaton's due process argument in this case would be inappropriate.

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[22]It is simply not true, as Eaton seems to suggest (Pet. 17), that California trial and appellate courts have historically neglected their duty to reduce excessive punitive damage awards. *See, e.g., Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 157 Cal.Rptr. 482 (1979) (California Supreme Court reversed $5 million punitive damage award as disproportionate and excessive); *Ramona Manor Convalescent Hos. v. Care Enterprises*, 177 Cal.App.3d 1120, 225 Cal.Rptr. 120 (1986) (court of appeal reversed $10 million punitive damage award and remanded for new trial unless plaintiff accepted reduction to $2.5 million); *Wayte v. Rollins Int'l, Inc.*, 169 Cal.App.3d 1, 215 Cal.Rptr. 59 (1985) (court of appeal affirmed trial court's reduction to $208,000 of one $950,000 punitive damage award, and its reduction of two other awards to $50,000 from $200,000); *Jahn v. Brickey*, 168 Cal.App.3d 399, 214 Cal.Rptr. 119 (1985) (court of appeal affirmed trial court's reduction of $250,000 punitive damage award to $100,000); *Sprague v. Equifax, Inc.*, 166 Cal.App.3d 1012, 213 Cal.Rptr. 69 (1985) (court of appeal affirmed trial court's reduction of $5 million punitive damage award to $1 million); *Goshgarian v. George, supra* (court of appeal reduced $15,000 punitive damage award to $7,500); *Burnett v. Nat'l Enquirer, Inc., supra* (trial court reduced $1.3 million punitive damage award to $750,000; court of appeal reduced it further to $150,000); *Grimshaw v. Ford Motor Co.*, 119 Cal.App.3d 757, 174 Cal.Rptr. 348 (1981) (court of appeal affirmed trial court's reduction of $125 million punitive damage award to $3.5 million); *Alhino v. Starr*, 112 Cal.App.3d 158, 169 Cal.Rptr. 136 (1980) (court of appeal remanded $150,000 punitive damage award); *Rosener v. Sears, Roebuck & Co.*, 110 Cal.App.3d 740, 168 Cal.Rptr. 237 (1980) ($10 million punitive damage award reduced to $2.5 million by court of appeal).

3. Neither California Punitive Damage Awards In General Nor The Award In This Case Lacks Predictability

Eaton's assertion that California punitive damage awards are wholly unpredictable reflects a misunderstanding of the views expressed by the Court and its individual members. When the Court and individual Justices have criticized punitive damage awards as "wholly unpredictable," they have uniformly done so only because a jury had unbridled discretion to assess such awards in amounts "bearing no necessary relation to the actual harm caused." *E.g., Gertz v. Robert Welch, Inc., supra*, 418 U.S. at 350. *See also Bankers Life, supra*, 108 S.Ct. at 1655 (O'Connor, J., concurring); *Rosenbloom v. Metromedia, Inc., supra*, 403 U.S. at 74 (Harlan, J., dissenting). California jury awards are not susceptible to this criticism, however, because California law *requires* that such awards bear a reasonable relationship to actual damages (*See* § II.B.1., *supra*).

California law further assures predictability as to the amount of punitive damage awards by requiring that punitive damages bear a reasonable relationship both to the wrongdoer's wealth and to the reprehensibility of the wrongdoer's misconduct.[23] Indeed, by requiring punitive damage awards to satisfy all of the foregoing criteria *in combination,* California law provides even greater predictability than state laws that require proportionality only to actual damages. *See e.g., United States v. National Dairy Products Corp.,* 372 U.S. 29, 35 (1963) ("the necessary specificity of warning is afforded when, as here, separate, though related, statutory elements of prohibited activity come to focus on one course of conduct.")

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[23]As Justice Harlan observed in discussing punitive damages in another context, all of the foregoing criteria are objectively ascertainable. *Rosenbloom v. Metromedia, Inc., supra,* 403 U.S. at 76 (Harlan J., dissenting) ("[t]he defendant's resources, the actual harm suffered and the [wrongful conduct's] potential for actual harm are all susceptible of more or less objective measurement.")

Eaton apparently complains that, even though punitive damage awards in California must be proportionate to all of these three criteria, the amount of such awards is not predictable in advance with mathematical precision. However, the Constitution does not require the mathematical precision that Eaton seems to desire. As the Court stated in *Roth v. United States,* 354 U.S. 476 (1957):

> "This court . . . has consistently held that lack of precision is not itself offensive to the requirements of due process. '* * * [T]he Constitution does not require impossible standards'; all that is required is that the language 'conveys sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices. * * *' "

354 U.S. at 491, *quoting United States v. Petrillo,* 332 U.S. 1, 7-8 (1947).

The multiple criteria that punitive damages must satisfy in California convey, in the words of *Petrillo,* "sufficiently definite warning . . . when measured by common understanding and practices." To require greater specificity would deprive juries of the flexibility that this Court has recognized they need in exercising their discretion to award punitive damages in amounts appropriate to the circumstances of each case. *See Barry v. Edmunds,* 116 U.S. 550, 565 (1886); *Day v. Woodworth,* 54 U.S. (13 How.) 363, 371 (1852). *Cf. Nash v. United States,* 229 U.S. 373, 377 (1913) (Holmes, J.) (due process is not offended merely because a defendant's punishment "depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree.")

The jury's punitive damage award satisfied all of the standards of proportionality required by California law. The amount of the award, moreover, was much less than the complaint's $25 million punitive damage prayer — which Eaton knew about from the moment it became a party to this litigation (*see* note 5, *supra*). It is thus inaccurate to suggest that the punitive damage award in

this case was unreasonably — or at all — unpredictable or violative of due process.[24]

C. The Courts Below Properly Imposed Liability On Eaton For Cutler-Hammer's Punitive Damage Obligations Under A Rational State Statute Designed To Implement Legitimate State Interests. Eaton's Due Process Challenge To These Lower Court Holdings Thus Does Not Merit Review

Eaton finally contends that this Court should review whether the courts below violated the Fourteenth Amendment's Due Process Clause by requiring the surviving corporation in a merger (Eaton) to pay the punitive damage liabilities of the disappearing corporation (Cutler-Hammer). (Pet. 23-26). The lower court holdings, however, fully comply with due process.

The court of appeal held Eaton liable for Cutler-Hammer's punitive damage obligations pursuant to California Corporations Code § 1107(a). (App. A-51 to A-53). Section 1107(a) provides that a surviving corporation in a merger "shall be subject to *all the debts and liabilities* of [the disappearing corporation] in the same manner as if the surviving corporation had itself incurred them." (emphasis added). In ruling that this statutory language requires Eaton (as the surviving corporation) to pay Cutler-Hammer's punitive damage liabilities, the court of appeal followed settled California case law interpreting the phrase "all the debts and liabilities" in section 1107(a) to include the disappearing corporation's punitive damage liabilities. *See Marks v. Minnesota Mining & Mfg. Co.*, 187 Cal.App.3d 1429, 1434-35, 232 Cal.Rptr. 594

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[24]Eaton's due process argument is not at all bolstered by the abstract possibility that the standards governing California punitive damage awards might somehow permit an unpredictably high award in a hypothetical case. *Cf. Robinson v. United States*, 324 U.S. 282, 286 (1945). A party, like Eaton (as Cutler-Hammer's successor), "to whose conduct a [law] clearly applies may not successfully challenge it for vagueness." *Parker v. Levy, supra*, 417 U.S. at 756.

(1986); *Moe v. Transamerica Title Ins. Co.*, 21 Cal.App.3d 288, 303-05, 98 Cal.Rptr. 547 (1971).[25]

Since the court of appeal relied exclusively on section 1107(a), Eaton's contention that the court of appeal's holding violates due process necessarily constitutes an attack on the constitutionality of section 1107(a). (*See* Pet. 26). A statute will not, however, be held unconstitutional on due process grounds unless "it is of such a character as to preclude the assumption that it rests upon some rational basis." *United States v. Carolene Products Co.*, 304 U.S. 144, 152 (1938). Conversely, the statute will be upheld against a due process challenge if "there is an evil at hand for correction, and . . . it might be thought that the particular legislative measure was a rational way to correct it." *Williamson v. Lee Optical Co.*, 348 U.S. 483, 488 (1955). Thus, to sustain its constitutional challenge, Eaton must establish that the California legislature could have had no rational basis for enacting section 1107(a), and that it therefore "acted in an arbitrary and irrational way." *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976). *See also Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 124-25 (1978).

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[25]Eaton is wrong in asserting (Pet. 24-25) that before the court of appeal's decision, California courts required the surviving and disappearing corporations to share an "identity of interest" (a phrase invented by Eaton that appears in no California judicial opinion) as a precondition to imposing liability on the surviving corporation for the disappearing corporation's punitive damage obligations. Indeed, the seminal *Moe* case has repeatedly been cited for the proposition that the surviving corporation in a merger is, as a matter of law, subject to punitive damages for the torts of the disappearing corporation. *U.S. v. Oil Resources, Inc.*, 817 F.2d 1429, 1434 (9th Cir. 1987); *Marks, supra*, 187 Cal.App.3d at 1434; *Celotex Corp. v. Pickett*, 490 So.2d 35, 38 (Fla. 1986); *Krull v. Celotex Corp.*, 611 F.Supp. 146, 148 (N.D. Ill. 1985); *Neal v. Carey Canadian Mines, Ltd.*, 548 F.Supp. 357, 391 (E.D. Pa. 1982) *aff'd on other grounds, Baskirk v. Carey Canadian Mines*, 760 F.2d 481 (3d Cir. 1985). The federal court decision in *In Re Related Asbestos Cases*, 566 F.Supp. 818 (N.D. Cal. 1983), on which Eaton relies, does not address section 1107(a).

Section 1107(a) plainly has a rational basis. It furthers the important purpose of deterring prospective corporate merger candidates from engaging in reprehensible conduct. A potential acquisition target will obviously sell for less, or not at all, if it engages in conduct that later might subject an acquiring corporation to substantial punitive damages liability. A law imposing on the surviving corporation in a merger responsibility for the disappearing corporation's punitive damage liabilities thus provides a powerful incentive to corporate acquisition candidates to refrain from any such misconduct. *See, e.g., Celotex Corp. v. Pickett, supra,* 490 So.2d at 38 (applying Florida's statutory equivalent of section 1107(a)).[26]

Eaton acknowledges this underlying reason for section 1107(a) (Pet. 25 n. 25), but contends that it is "arbitrary and capricious." (Pet 24). To support this contention, Eaton argues that "logic does not sustain" the legislature's conclusion that requiring a surviving corporation to pay the disappearing corporation's punitive damage liabilities deters corporate acquisition candidates from engaging in reprehensible behavior. (Pet. 25-26 n. 25). But as indicated above, the legislature could reasonably have concluded otherwise. Eaton's disagreement with the wisdom of this conclusion raises policy questions which should be addressed to the legislature; it does not, however, raise due process concerns. *See, e.g., Exxon Corp. v. Governor of Maryland, supra,* 437 U.S. at 124-25; *Ferguson v. Skrupa,* 372 U.S. 726, 730-31 (1963).

Eaton also complains that it is "innocent" of any wrongdoing and that the law ordinarily does not impose punitive damages upon innocent parties. From these premises, Eaton concludes, without explanation, that requiring a surviving corporation in a merger to assume the disappearing corporation's punitive damage liabilities necessarily violates due process. (Pet 23-24, citing *Lake*

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[26]Section 1107(a) also prevents corporations from using mergers as a means of avoiding punishment for their reprehensible behavior. This is yet another rational basis for the statute.

Shore & M.S. Ry. Co. v. Prentice, 147 U.S. 101 (1893) and *City of Newport v. Fact Concerts, Inc.,* 453 U.S. 247 (1983)). This argument lacks merit for several reasons.

First, neither *Lake Shore* nor *Fact Concerts* involved due process questions. *Lake Shore* applied federal common law principles; *Fact Concerts* involved only a question of statutory construction.

Second, even if Eaton's characterization of itself as "innocent" were accurate, it does not automatically follow, as Eaton suggests, that requiring it (as the surviving corporation) to pay Cutler-Hammer's punitive damage obligations *a fortiori* violates due process. Where, as here, a rational basis exists for a statute, the Court will not disturb the statute on due process grounds merely because, as Eaton argues, the legislation is purportedly "unwise, improvident or out of harmony with a particular school of thought." *Williamson v. Lee Optical Co., supra,* 348 U.S. at 488. Eaton's quarrel with the legislature's decision to require so-called "innocent" surviving corporations to pay the disappearing corporation's punitive damage obligations is for the legislature, not the courts. *See Ferguson v. Skrupa, supra,* 372 U.S. at 730 n. 7.[27]

Third, Eaton's characterization of itself as an "innocent" party "distinct" from wrongdoer Cutler-Hammer is inaccurate. Upon completion of the merger Cutler-Hammer became a division of Eaton known as the "Cutler-Hammer Group" (Ex. 1347, p. 13). Thus, after the merger, Cutler-Hammer was an *inseparable part* of Eaton. *See, e.g., Moe v. Transamerica Title Ins. Co., supra,* 21 Cal.App.3d at 304 (a merger "does not create an entirely new entity but " ' "merely directs the blood of the old corporation into the veins of the new, the old living in the

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[27]Eaton, moreover, is incorrect in arguing (Pet. 26) that vicarious punishment of purportedly "innocent" parties is a concept foreign to the law. *See, e.g., Shapiro, Bernstein & Co., Inc. v. H. L. Green Co.,* 316 F.2d 304 (2nd Cir. 1963) (copyright infringement.)

new" ' " (citations omitted)).[28] There is thus no merit to Eaton's assertions of "distinctness" or "innocence."

Nor is there merit to Eaton's final contention that the court of appeal's interpretation of section 1107(a) treats its shareholders unfairly. Had Eaton wished to absorb Cutler-Hammer *without* becoming subject to Cutler-Hammer's punitive damage liabilities, it could easily have done so by leaving Cutler-Hammer intact as a separate corporation and purchasing either Cutler-Hammer's stock or its assets. Instead, Eaton made the considered decision on behalf of its shareholders to absorb Cutler-Hammer in a merger, knowing full well that this lawsuit — including its $25 million punitive damage claim against Cutler-Hammer — was pending.[29] There is no unfairness in holding Eaton and its shareholders to the consequences of this conscious choice. *See Krull v. Celotex, supra*, 611 F.Supp. at 149.

In short, Eaton's due process challenge to section 1107(a) — which Eaton has failed to support with a citation to even one due process case — raises no issues meriting review by this Court.

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[28]Moreover, the very corporate officers responsible for Cutler-Hammer's fraudulent conduct in this case succeeded to managerial positions at Eaton. (30 R.T. 5254-61).

[29] Indeed, despite its knowledge of Cutler-Hammer's potential punitive damage liability, Eaton expressly agreed in the written merger agreement to assume all of Cutler-Hammer's "debts, liabilities, obligations and duties [as if they] had been incurred or contracted by [Eaton]" (Ex. 1049, ¶5).

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED: March 31, 1989.

Respectfully submitted,

STEPHEN A. KROFT,
(Cousel of Record),
ROBERT H. ROTSTEIN
KELLY W. KAY

Attorneys for Respondent
The PKL Companies, Inc.

Of Counsel
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APPENDIX 1

SUPERIOR COURT OF CALIFORNIA, COUNTY OF LOS ANGELES

C185010
THE PKL CORPORATION

vs

MACRODATA CORPORATION, et al.

HONORABLE ALFRED L. MARGOLIS, JUDGE
V. HIRANO, Deputy Clerk
E. V. SCHNEIDER, Reporter

DEPT. 40

NATURE OF PROCEEDINGS: Deft's Motion for New Trial, etc., et al.

Matter resumes from 10/31/83. Argument continues.

The Court denies the Motion for New Trial and the Motion for the Judgment notwithstanding the Verdict.

The following order is mailed this date as follows:

ROSENFELD, MEYER & SUSMAN
c/o JOHN G. DAVIES, KAREN GARVER
& FRANK A. URIBIE
9601 WILSHIRE BLVD. 4th Floor
BEVERLY HILLS, CA 90210

RINTALA, SMOOOT & JAENICKE
c/o PETER C. SMOOT
1875 CENTURY PARK EAST, SUITE 1220
LOS ANGELES, CA 90067

McCUTCHEN, BLACK, VERLEGER & SHEA
c/o WARD L. BENSHOOF
& LOUIS A. KARASIK
500 WILSHIRE BLVD.
LOS ANGELES, CA 90017

APPENDIX 2

"RULE 28. Review by Supreme Court

. . .

(e) [Form of petition, answer and reply]

. . .

(2) At the beginning of the body of the petition, the petition shall state the issues presented for review, expressed in the terms and circumstances of the case but without unnecessary detail. The statement should be short and concise and should not be argumentative or repetitious. The statement of an issue will be deemed to comprise every subsidiary issue fairly included in it. Only the issues set forth in the petition and answer or fairly included in them need be considered by the court.

. . .

RULE 29. Grounds for Review in Supreme Court

. . .

(b) [Limitations] As a matter of policy, on petition for review the Supreme Court normally will not consider:

(1) any issue that could have been but was not timely raised in the briefs filed in the Court of Appeal; . . ."

APPENDIX 3

The following is the entire text of the issues presented for review in Eaton Corporation's Petition for Review filed in the California Supreme Court:

"ISSUES PRESENTED FOR REVIEW

. . .

"The issues presented for review in this Petition are as follows:

1. May punitive damages of $15,000,000 be imposed on a totally innocent corporate successor for the conduct of a predecessor which has completely ceased to exist, expecially where no separate identity of the predecessor remains in the successor?

This issue calls for resolution by this Court of confusion in the reported decisions concerning the application of Cal. Corp. Code § 1107 to punitive damages, and a determination whether the public policy that punitive damages are improper unless assessed against the party actually responsible for the wrong applies equally to successor corporations.

2. Where a minority shareholder has profited more than $1.2 million on its investment, is a $15,000,000 punitive damage windfall, constituting 10% of the wrongdoer's net worh[sic] and 62% of its net income, excessive under common law principles and California statutes?

This issue calls for this Court to determine whether *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 169 Cal.Rptr. 691 (1979), which held that a punitive award constituting 58% of the wrongdoer's net income was 'excessive as a matter of law' (24 Cal.3d at 824), is controlling law in this state and prohibits a punitive award that is three times greater than any prior punitive award affirmed in a published opinion by the courts of California.

3. Where a minority shareholder deliberately waives its statutory right under Cal. Corp. Code § 1300 *et. seq.* to Court supervised appraisal of the value of its shares in a merger, may the minority nonetheless pursue a jury trial to dispute the merger price?

This question calls for this Court to determine an issue left for future decision in *Steinberg v. Amplica, Inc.*, 42 Cal.3d 1198, 233 Cal.Rptr. 249 (1986); is the appraisal remedy, found by this Court in *Steinberg* to be both the adequate and exclusive remedy under Cal. Corp. Code § 1312(a) for disputes over fair value in a merger, rendered optional by the limited exception to exclusivity found in § 1312(b); *i.e.*, does the exception permit litigation over the fair value of stock in a 'common control' merger and claims for punitive damages?

4. Are minority shareholders entitled to jury trials for resolution of the equitable restrictions imposed on majority shareholders under *Jones v. Ahmanson*, 1 Cal.3d 93, 81 Cal.Rptr. 592 (1969)?

This question calls for this Court to decide if its holding in *C & K Engineering Contractors v. Amber Steel Co.*, 23 Cal.3d 1, 151 Cal.Rptr. 323 (1978) that there is no right to jury trial for a claim which would not exist but for the application of equitable principles, applies to the cause of action for breach of majority shareholder duty established by *Jones*.

5. If jury trials are to be had for breach of majority shareholder duty under *Jones*, what are the elements of the cause of action to be submitted to the jury?

May a jury be instructed to 'presume fraud' if the majority has some 'advantage' over the minority? Is the defendant entitled to instructions which define 'advantage' and identify the several plain advantages possessed

by the majority which are incompetent, as a matter of law, to show breach of duty under *Jones*?

6. Where the appellate court exonerates an employee/defendant of wrongdoing and makes findings of fact about both his conduct and that of the plaintiff, may the appellate court in a subsequent appeal in the same action hold the employer/defendant liable for conduct by the employee which the prior decision concluded did not occur, and make other findings of fact expressly contrary to the prior appellate decision?

This issue presents questions of the jurisdiction of trial courts under Cal. Code Civ. Proc. § 916(a) to adjudicate matters that have been appealed, and calls for this Court to reaffirm the principle of *Southern Pacific Railway Co. v. Los Angeles*, 5 Cal.2d 545, 55 P.2d 847 (1936), that it is impermissible for two appellate courts to 'reach [ ] diametrically opposite conclusions as to the legal effect of the same occurrence, where the essential same facts are similarly presented' (5 Cal.2d at 548)."

(Petition For Review, pp. 2-3)

APPENDIX 4

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Telephone (213) 624-2400
Telex: 698261

May 31, 1988

Court of Appeal Second District
F I L E D
May 31, 1988
Robert N. Wilson, Clerk

HAND DELIVERED
Clerk, Division Five
Second Appellate District
3580 Wilshire Boulevard, Room 301
Los Angeles, California 90010

Re: PKL v. Eaton Corporation:
2d Civil No. B010958

Dear Sirs:

In connection with the hearing on this appeal on June 1, 1988, appellant Eaton Corporation wishes to bring to the Court's attention the decision in *Sax v. World Wide Press, Inc., et al.,* 809 F.2d 610 (9th Cir. 1987). *Sax* was decided subsequent to the parties' briefing of the issues, and is thus an addendum to pages 122-123 of Eaton's Opening Brief setting forth authorities governing the disposition of derivative claims.

For the Court's convenience, five copies of this federal decision are enclosed with this letter.

Very truly yours,

HOWARD J. PRIVETT
Howard J. Privett of
McCUTCHEN, BLACK,
VERLEGER & SHEA

Enclosures
cc: Stephen A. Kroft, Esquire [HAND DELIVERED]

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA
COUNTY OF LOS ANGELES } ss.:

I am a citizen of the United States and a resident of or employed in the City of Los Angeles, County of Los Angeles; I am over the age of 18 years and not a party to the within action; my business address is 1706 Maple Avenue, Los Angeles, California 90015.

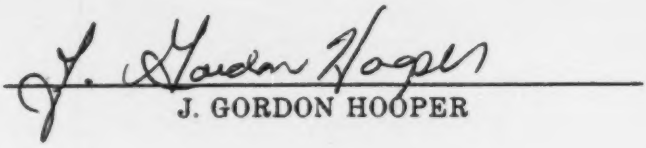
On March 31, 1989, I served the within Brief of Respondent in Opposition in re: "Eaton Corporation vs. The PKL Companies, Inc." in the United States Supreme Court October Term 1988, No. 88-1354, on all parties interested in said action, by placing three true copies thereof enclosed in a sealed envelope, with postage thereon fully prepaid, in the United States Post Office mail box at Los Angeles, California, addressed as follows:

Howard J. Privett
McCutchen Black, Verleger & Shea
600 Wilshire Boulevard
12th Floor
Los Angeles, California 90017
Attorneys for Petitioner

All parties required to be served have been served.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on March 31, 1989, at Los Angeles, California.



J. GORDON HOOPER